In the Supreme Court
OF THE
United States

OCTOBER TERM, 1971

No. 71-824

HARVEY and ELAINE SIEGEL, et al., *Plaintiffs-Petitioners*,

vs.

LANCER DISTRICT, Inc., et al., *Defendants-Respondents*.

BRIEF OF RESPONDENTS IN OPPOSITION

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CHICKEN DELIGHT, INC., et al., *Defendants-Respondents*.

BRIEF OF RESPONDENTS IN OPPOSITION

Respondents Chicken Delight, Inc., Chicken Delight of California, Inc. and Consolidated Foods Corporation respectfully pray that the Petition for a Writ of Certiorari (No. 71-824) filed December 23, 1971 by Harvey Siegel, *et al.*, be denied. However, respondents urge that their own Petition for Writ of Certiorari (No. 71-810) filed December 20, 1971 be granted.

THE CHICKEN DELIGHT FRANCHISE SYSTEM

The franchisees' Petition and this Brief in Opposition relate solely to the issue of damages upon which the Ninth Circuit has reversed and remanded the case to the

district court for further trial. As respects the damage issue, the following facts are pertinent:[1]

Under Chicken Delight's standard form franchise contracts, its licensees have been authorized to use the franchisor's registered trademarks and system of operation for the purpose of selling at retail a limited menu of exclusive-recipe food items. Respondents' franchisees are charged no initial franchisee fee; nor are they obligated to pay a percentage of their gross sales by way of royalty to the franchisor for use of the trademark and system license. However, as consideration for the license and as a condition of operation as a Chicken Delight franchisee, the licensee agrees to purchase his full requirements of the so-called required items (*i.e.*, paper packaging, dry-mix food items and certain cooking equipment) from the franchisor exclusively, at prices specified in the franchise agreement. The sale of these items provides Chicken Delight with its sole source of trademark revenue. Accordingly, Chicken Delight's stated price for the required items has included, in addition to its cost of the goods, a franchisor's mark-up, *i.e.*, a mark-up believed sufficient to compensate Chicken Delight for the reasonable value of its licensed trademarks and system. Respondents contend that the contractual prices thus paid by the franchisees are equal to the fair market value of the tying and tied products received in return.

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[1]For purposes of this Brief in Opposition, it is assumed *arguendo* that Chicken Delight's contractual requirements practice involves a tie-in. In fact, that claim is strenuously disputed by respondents and forms the subject matter of a cross-petition for certiorari which is now pending before this Court (No. 71-810).

Since most companies in the fast-food industry derive compensation for their trademark license through a separately stated franchise fee and royalty based upon a percentage of franchise sales, Chicken Delight offered evidence at trial which stated the economics of its system in this more common framework. Respondents (as well as the franchisees) presented evidence which demonstrated that Chicken Delight's total mark-up on the sale of the required commodities was approximately 3.2-3.6% of its franchisees' sales. Further, respondents offered evidence, by way of an industry-wide survey, to show that this percentage did not exceed the average separately stated royalty charged by comparable franchise companies. The bulk of this evidence was excluded by the trial court as legally irrelevant.

THE DECISIONS BELOW RESPECTING THE FACT OF DAMAGE

In granting the franchisees' motion for directed verdict, the district court held that the fact of damage was established as a matter of law by proof that the prices Chicken Delight charged for the required (tied) commodities were higher than those charged by third-party sellers of comparable items. The court further held that any evidence respecting the value of the *tying* product (the Chicken Delight trademark license) was, as a matter of law, irrelevant. Necessarily the effect of its ruling was to fix not only the fact, but also the measure, of the franchisees' damages. See Appendix B to the Petition herein at 28.

On appeal, the Ninth Circuit reversed the district court's damage holding and remanded the case for further trial on that issue. The Court of Appeals held that in determining whether Chicken Delight's tying practice had caused injury to the franchisees, it was necessary to compare the prices actually paid by the franchisees with what it would have cost them to purchase the tying as well as the tied items, if purchased free from the unlawful arrangement. Appendix A to the Petition at 16.

QUESTION PRESENTED

The franchisees' Petition appears to raise the following question:

> In a buyer's treble damage action based upon an alleged tie-in, is the value of, and price paid for, the tying product irrelevant as a matter of law in determining whether the buyer has been damaged as a proximate result of the challenged practice?

ARGUMENT

A. THE NINTH CIRCUIT'S DAMAGE HOLDING DOES NOT PRESENT ANY SUBSTANTIAL OR UNRESOLVED QUESTION REQUIRING REVIEW BY THIS COURT.

The franchisees' lengthy discussion of the "fact of damage" issue suggests that the decision below is in some way novel, or is contrary to established antitrust precedent. In fact, the challenged holding is demonstrably correct; in order to determine whether plaintiff-franchisees have been damaged in any amount as a result of Chicken Delight's allegedly unlawful tying practice, it is necessary to con-

sider what it would have cost them to purchase *both the tied and the tying products* separately and in the absence of the tie-in. As the Ninth Circuit stated:

> By its own terms, Clayton Act recovery is available only where actual injury has been suffered. Wickler & Smith Citrus Products Co. v. Sunkist Growers, Inc., 346 F.2d 1012, 1014 (9th Cir. 1965). The question here is whether the plaintiffs have suffered injury by virtue of the unlawful arrangement to which they were subjected. That arrangement of necessity involved both tying and tied products. To ascertain whether an unlawful arrangement for the sale of products has caused injury to the purchaser, the cost or value of the products involved, free from the unlawful arrangement, must first be ascertained. Cf., Perma Life Mufflers, Inc. v. Int'l Parts Corp., 392 U.S. 134, 140, 88 S.Ct. 1981, 20 L.Ed.2d (1968). (See Appendix A to the Petition at 16).

The franchisees view the matter differently. To establish the fact of damage, they assert, the total prices paid by franchisees under the assumed tie-in should be compared *only* with prices charged by third-party sellers for items comparable to the "tied" commodities (*e.g.*, paper plates, batter dip, etc.). For the franchisees, the tying product is deemed an "extrinsic" factor, and all evidence pertinent to its market value is irrelevant as a matter of law. In short, for damage purposes, the franchisees suggest that the economically powerful tying product—vital to proof of illegality in the first instance—is to be disregarded, or valued at zero.

Yet if it be assumed that the franchisees should have been free to purchase the tying and the tied products sep-

arately, it would still have been necessary for them to have acquired and used both the Chicken Delight trademark license and the required commodities in order to operate as Chicken Delight franchisees.[2] In such circumstances, as the Ninth Circuit recognized, it makes no sense to determine the existence of damages by comparing the prices paid under the challenged tying arrangement solely with prices those franchisees would have paid for the tied commodities, if available from other sources, without also taking into account the cost of the tying product absent the restraint.

The franchisees' Petition nonetheless argues that the Ninth Circuit's holding accords respondents an "offset" against established overcharge damages for the reasonable value of the Chicken Delight trademark license. Petition at, *e.g.*, 12-14. That claim, however, is based upon a fundamental misconception. Far from granting any "offset" against a demonstrated overcharge, the opinion below correctly notes that the value of the trademark license must be considered in the first instance in determining whether there has in fact been any overcharge. For if the amount franchisees paid under the assumed tying arrangement did not exceed the market value of the essential components of that arrangement—*i.e.*, both the trade-

[2]The franchisees have conceded that Chicken Delight could properly have required them to *use* the required commodities in their franchise operations. They dispute only the requirement that such commodities be purchased from Chicken Delight. It is also undisputed that the franchisees would have neither the right nor the desire to purchase special Chicken Delight trademarked packaging and the other required commodities unless they also had a license to use Chicken Delight's trademark and system.

mark license and the required commodities—there has been no overcharge, and no damage.[3]

Similarly, the franchisees' contention that proof of damage under the Ninth Circuit decision would be overly complex and require lengthy trial proceedings is without merit. Petition at 19-22. As an initial matter, it is clear that mere complexity cannot excuse the treble damage plaintiff from proving actual injury, as required by §4 of the Clayton Act. Moreover, the franchisees' suggestion of difficulty here is seemingly little more than *in terrorem*. In the usual case, valuation of the tying product presents no difficulty because it is a tangible article of commerce. The fact that here the tying product is a trademark license may render valuation somewhat less precise, but no more complex. In this connection, we note that at the initial trial, the franchisees' own distributor witness, long familiar with the field of fast-food franchising, opined that a royalty of 3.5% of franchisee gross sales constituted reasonable compensation for use of a trademark license and was comparable to rates charged by numerous other franchising firms. Defendants' market studies were to the same effect. What is more, this type of evidence is no different in kind from that traditionally employed by plaintiffs and defendants alike in treble damage actions

[3]The franchisees also suggest that the decision below is contrary to established antitrust policy notions favoring the private treble damage action. While the importance of the private remedy is, of course, well-settled, it still remains a statutory precondition of recovery for the plaintiff to prove that he has in fact suffered injury as a result of defendants' unlawful conduct. See 15 U.S.C. §15. See, *e.g.*, *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 562 (1931); *Gottesman v. General Motors Corp.*, 414 F.2d 956, 961 (2nd Cir. 1969); *Flintkote Co. v. Lysfjord*, 246 F.2d 368, 392 (9th Cir. 1957). Compare also Timberlake, FEDERAL TREBLE DAMAGE ANTITRUST ACTIONS, §20.02 (1965).

under the rubric of "the yardstick." See, *e.g.*, *Bigelow v. RKO Radio Pictures*, 327 U.S. 251 (1946); *Richfield Oil Corp. v. Karseal Corp.*, 271 F.2d 709 (9th Cir. 1959) *cert. denied*, 361 U.S. 961 (1961). Compare Timberlake, FEDERAL TREBLE DAMAGE ANTITRUST ACTIONS, *supra* at §21.11.

B. THE NINTH CIRCUIT'S DAMAGE HOLDING IS NOT CONTRARY TO PRIOR DECISIONS OF THIS COURT

The franchisees further contend that there is a conflict between the opinion of the Ninth Circuit below and prior decisions of this Court, particularly *Hanover Shoe v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968) and *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969). No such conflict, either in holding or principle, in fact exists.

(1) *Hanover Shoe.* The franchisees place principal reliance upon this Court's "passing on" decision in the *Hanover Shoe* case. In *Hanover*, defendant United was found to have monopolized the shoe machinery industry as a result of its "lease only" policy. The district court further found that as a result of this illegal practice, plaintiff Hanover was damaged in the amount by which its payments for machines leased from United exceeded the costs Hanover would have incurred had it been able to purchase the machines from United. On appeal, the damage award was affirmed by this Court, which further held (in the most widely cited aspect of the case), that defendants were not entitled to reduce plaintiffs' damage claim by showing that Hanover had in fact "passed on" some or all of the excess cost through increased sales prices to its third party customers.

But nothing in *Hanover* is contrary to the decision below. First, unlike defendant United, respondents here do not claim that its franchisees have "passed on" increased costs to their retail customers, or that they are thereby entitled to an offset. Moreover, in *Hanover*, the violation had concededly enabled defendant United to reap from its buyers a higher price than would have otherwise been obtainable for the property sold. Thus, overcharge damages had been sustained *by someone*—in the first instance by the buyer, and in any event by its customers who were obliged to pay the higher ("passed on") prices. Yet in the absence of proof that Chicken Delight obtained more than the market value of both the trademark license and required commodities, *no one* has suffered overcharge damages, and neither sound economics nor antitrust policy requires the creation of artificial damages where none exist.

The Ninth Circuit's decision is in fact fully consistent with *Hanover*. As noted, the district court found that plaintiff Hanover had been damaged by having paid more to lease defendants' machines than it would have paid if the machines had been available for purchase. Significantly, in computing the amount Hanover "would have paid," the court did not look merely to the probable purchase price, but added to that price other direct costs Hanover would have incurred in a purchase transaction. Thus, in determining the amount of the claimed overcharge, the court took into account (1) the amount of interest which Hanover would have paid on money borrowed to purchase the machines and (2) the probable amount it would have cost Hanover to maintain and repair the machines if it had

purchased them outright from United (which had previously provided such service *without separate charge* under its lease-only arrangement). This latter aspect of *Hanover* bears striking resemblance to the situation at bar, where Chicken Delight's trademarks and system were licensed without separate charge in conjunction with the sale of the required packaging, food and equipment items.

The court in *Hanover* at no point suggested that United's failure to have charged separately for maintenance and repair required the assumption that plaintiff could have obtained that service free of charge absent defendants' unlawful leasing practice. Likewise here, the Ninth Circuit properly held that the value of respondents' trademark and system license, which was provided to franchisees without separate charge as an integral part of the alleged tying arrangement, cannot realistically be disregarded in determining the existence of the purported overcharge.

(2) *Lear, Inc. v. Adkins.* The franchisees' reliance upon *Lear, Inc. v. Adkins, supra,* is equally misplaced. *Lear,* which was a non-antitrust patent case, is cited by the franchisees for the proposition that a court will not permit a patentee to recover unpaid royalties where the patent has been used to violate the antitrust laws. Petition at 25-26. From this, the franchisees assert that the value of the Chicken Delight trademark license cannot be considered in assessing damages, and that all consideration paid under their contracts in excess of the separate value of the "tied" products must be refunded to them trebled.

The franchisees have both miscited and misinterpreted *Lear.* First, the primary thrust of that case was this

Court's overruling of the unique patent doctrine of "licensee estoppel" under which a patent licensee was formerly prevented from attacking the validity of a licensed patent during the license term. Indeed, the case's only ruling with respect to royalties was its corollary holding that an *affirmative suit* to recover upaid royalties will not lie where patent invalidity is established.

Yet that holding in no sense supports the franchisees claim here since refusal to permit recovery of royalties under license of an invalid patent reflects no more than proper recognition of the fact that the patent, since invalid, was of little or no value to the licensee. By contrast, the franchisees here, far from attacking the validity or value of Chicken Delight's trademarks and system license, have made the purported market power of that license the very cornerstone of their claim of illegality.

C. THE FRANCHISEES' PETITION FOR REVIEW OF THE NINTH CIRCUIT'S DAMAGE RULING IS IN ALL EVENTS PREMATURE

The mandate of the Ninth Circuit is a remand to the district court for a new damage trial to consider "the value of both tying and tied products, free from the tying arrangement." Appendix A to the Petition at 17. In these circumstances, the franchisees' present request for review of the Ninth Circuit's damage ruling is, at the least, premature.[4]

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[4]Respondents would observe that in contrast to the damage issue, which the Ninth Circuit remanded for trial, all questions respecting the legality of Chicken Delight's franchise contracts were resolved on the merits and are fully matured for consideration by

In reversing the trial court's directed verdict for plaintiffs, the Ninth Circuit has preserved to each of the parties an opportunity to present all evidence pertinent to the damage question at the trial court level. Thus, upon retrial, a full record will be created from which the question of both the fact and the amount of damage can be more fairly ascertained.[5] It is, of course, clear that upon retrial of the damage issue, the franchisees may still prevail in that the fact of damage might be found and damages actually awarded. In that event, this Court may never confront the damage contentions now urged by the franchisees. Conversely, in the event that the franchisees fail at trial with respect to the damage question, their right ultimately to petition this Court for a hearing is fully preserved. *Hamilton-Brown Shoe Co. v. Wolf Bros.*, 240 U.S. 251 (1916); *Panama Railroad Co. v. Napier Shipping Co.*, 166 U.S. 280 (1897); *White v. Higgins*, 116 F.2d 312 (1st Cir. 1940); 9 Moore, Fed. Practice, §110.25[2].

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this Court. As respects legality, both sides were accorded the opportunity of presenting all evidence pertinent to their theory of the case and the record before the Court respecting those aspects of the litigation is thus complete.

[5]It is to be anticipated that the evidentiary record which would be presented to this Court following retrial will be substantially fuller than the record currently at bar, since at the original trial the district court excluded much of Chicken Delight's proffered evidence respecting the value of its trademark license and the revenue practices of comparable franchising firms. Among the excluded evidence was a thorough survey of comparable franchisors' revenue practices and an accountant's computation of Chicken Delight's profits on the sale of required items expressed as a percentage of franchisee gross sales. As noted above, the function of this evidence was to demonstrate that Chicken Delight's mark-up on the required items was substantially equivalent to the initial franchise fees and royalty rates charged by other franchisors for the licensing of their trademarks and system, and that the franchisees had thus suffered no overcharge.

The franchisees' only response to the obvious prematurity of their claims is again the suggestion that a retrial will be overly "long and complex." Petition at 19. Even this claim, however, ignores the conceded fact that whatever the disposition of the damage issue in this Court, the case must still be returned for further proceedings respecting the amount of damages, both on a class-wide and individual basis. There also remain to be considered *de novo* important issues respecting (1) Consolidated Foods Corporation's liability as Chicken Delight's parent corporation, (2) Chicken Delight's counterclaim for goods sold and delivered, (3) Chicken Delight's counterclaim for the reasonable value of its trademark license as against franchisees who have paid nothing therefor during the pendency of these proceedings, and (4) Chicken Delight's claim that, if its franchise agreements be held unlawful, they are voidable and terminable by Chicken Delight for failure of consideration. This latter issue formed the subject matter of the companion petition for mandamus which was denied, without prejudice, by the Ninth Circuit (see Appendix A to the Petition herein at 17-18).

In light of the substantial issues which remain to be tried in all events, any potential economy effected by review of the damage issue at this time is substantially outweighed by the interlocutory character of the damage issue, the opportunity for review upon a more complete record hereafter, and the possibility that no review will even be sought following retrial.

CONCLUSION

The decision of the Ninth Circuit correctly applied established antitrust damage principles to the facts at bar and properly directed that the damage issues should now be fully tried. There is no basis for this Court to review that decision.

Accordingly, for the reasons set forth above, respondents herein respectfully request that the franchisees' Petition for a Writ of Certiorari be denied and further request that their Petition for Writ of Certiorari be granted.

Dated, San Francisco, California,
January 18, 1972.

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